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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Changing Pattern Of French-Algerian Economic Relations

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
June 1971

INTELLIGENCE MEMORANDUM

The Changing Pattern Of French-Algerian Economic Relations

Introduction

1. The strong economic ties between France and Algeria that were developed during the long colonial period were continued after Algerian independence under a series of preferential agreements. In early 1971, however, these ties were seriously disrupted when ongoing economic negotiations quickly escalated into a crisis. As an immediate consequence, Pomidou declared an end to the "special relationship" between Algeria and France. French companies halted imports of crude oil from Algeria and took steps to dissuade other companies from buying "French-owned" Algerian oil. The purpose of this memorandum is to review the state of Algerian-French economic relations, the impact of the current crisis, and the economic consequences of several possible solutions.

Discussion

Historical Economic Ties

2. A close economic relationship developed throughout the long colonial period 1/, during the latter part of which Algeria was considered a part of metropolitan France. No restrictions were imposed

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1. Terminating more than a century of French rule, Algeria obtained its political independence in 1962.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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on the flow of goods, capital, or people that did not also apply to other departments of France. Thousands of Algerians migrated to France where they earned higher wages, a sizable share of which was remitted to families in Algeria. Thousands of French farmers moved to Algeria, and by the end of the colonial period much of the best land was owned and operated by Frenchmen. Private French investment in Algeria was concentrated in agriculture, mining, and the fledgling petroleum industry. Many French construction firms and service industries also opened Algerian branches.

3. There was little formal effort to develop the Algerian economy until the late 1950s, when concern over political control led to formulating the Constantine plan for general economic development. While the pace of infrastructure development was stepped up and a housing program begun, little of the plan had been implemented by independence.

4. In the immediate post-independence years, most historic French-Algerian economic ties were preserved by preferential economic policies. France gave Algerian exports favorable quota or tariff preferences, and most Algerian trade continued to be with the former Metropole. Substantial French aid financed Algerian government expenditures and French companies still operated Algeria's banks, mines, and the growing petroleum industry. Most agricultural holdings and light industry, however, were seized by Algeria immediately following independence. Meanwhile, Algerians continued to migrate to France, which in turn supplied teachers and technical personnel.

5. During the 1960s, however, French-Algerian economic ties were gradually eroded (see Table 1). Although committed under a 1964 agreement to buy a total of one billion gallons of Algerian wine during 1964-68, Paris defaulted on the agreement and actual shipments were 30% lower than stipulated.2/ In retaliation, Algiers imposed tariffs on many French goods. In 1965, Algeria and France signed an oil accord which gave Algeria much greater revenues and control over industry operations and provided for developing the state-owned oil firm, SONATRACH. By 1968, French interests in the financial and mining

2. The declining trend of French imports of Algerian wine was interrupted in 1969 and 1970 as a result of a very poor French grape harvest in 1969.

Table 1

Evolution of French-Algerian Economic Relations

	1963	1964	1965	1966	1967	1968	1969
Trade							
Algerian exports to France (million US $) a/	565	559	577	524	425	453	481
Percent of total Algerian exports	75	80	77	72	59	55	55
Algerian imports from France (million US $) b/	559	490	466	433	376	455	419
Percent of total Algerian imports	81	71	70	69	60	57	44
Algerian wine exports to France (million US $) c/	102	146	158	119	49	43	76
Percent of total wine exports d/	99	94	94	89	70	53	41
Algerian oil exports to France (million US $) c/	306	332	338	340	399	441	440
Percent of total Algerian oil exports e/	72	70	69	59	60	60	60
Percent of total French oil imports e/	35	35	30	29	30	32	30
Aid							
Total French aid to Algeria (million US $)	N.A.	N.A.	126	104	92	111	104
Technical assistance (million US $)	N.A.	N.A.	41	40	39	41	43
Financial assistance (million US $)	N.A.	N.A.	85	64	53	70	61
Of which:							
Grants (million US $)	N.A.	N.A.	85	63	52	62	33

a. F.O.B. Algeria.
b. C.I.F. Algeria.
c. C.I.F. France.
d. An abnormally poor grape harvest in France caused high wine exports from Algeria in 1969.
e. Based on quantity.

sectors had been nationalized. Although still present in large numbers, French technical assistance personnel decreased somewhat. Growing oil revenues led to large balance of payments surpluses, despite the fact that French financial aid was sharply reduced.

French-Algerian Relations Immediately Before the Rupture

6. Despite the movement away from France, ties were still relatively strong as the decade ended. France continued to buy about 60% of Algeria's crude oil exports, and most other Algerian goods, except for wine, entered free of most restrictions. In 1969, France took 55% of Algeria's exports and supplied 44% of its imports. Algeria, France's largest trade partner outside of Western Europe and the United States, accounted for more than 3% of French foreign trade. Although official financial aid had dwindled, commercial credits financed a large portion of French exports to Algeria. Many development projects were under contract to French companies, and Algeria continued to depend on French technical assistance. More than 70% of the 10,000 Frenchmen in Algeria supported by French technical assistance grants were teachers, the remainder were mainly in health and agriculture. The Algerian community in France was still large, numbering more than 400,000 workers who remitted nearly $200 million annually. A net inflow of 35,000 permanent (as opposed to seasonal) workers was permitted each year.

7. Franco-Algerian petroleum relations continued to be mutually preferential. French companies produced about 70% of Algerian crude oil, supplied important technical skills and marketing facilities, and reinvested sizable sums in exploration. Widespread Algerian efforts to obtain control of non-French oil firms through joint-ownership arrangements or nationalization during 1967-70 had almost no impact on French-owned companies. Throughout 1970, Paris continued to pay guaranteed prices for Algerian oil and helped market it both in France and on the world market. French companies' taxes were lower than those of other foreign oil companies, and French companies were allowed to repatriate 50% of their profits from gross crude oil sales, compared with up to 25% for non-French foreign companies.

8. The Algerian workers in France were important to both countries, but more so to Algeria. For France, they represented a relatively stable supply of cheap labor; the vast majority of Algerians were nonunionized and accepted the legal minimum wage -- or less. They were more mobile than French workers; with no special ties to village, friends, or province, they were willing to work anywhere. These Algerian emigrants -- by far the largest foreign minority in France -- made up about 2% of the total labor force and provided a significant share of the work force in some industries, especially in construction. For Algeria, workers' remittances as a source of foreign exchange were exceeded only by crude oil exports. Moreover, the annual net inflow of permanent (as opposed to seasonal) workers permitted by France helped to alleviate high domestic unemployment among unskilled and semi-skilled workers. Although increasing numbers of professional and white collar workers emigrated to France, more than 80% of the Algerian workers were employed as manual or semi-skilled laborers. Algerians trained on-the-job in France may provide vital skills for future Algerian development.

9. Other remaining economic preferences, although not especially important to either country, probably benefited Algeria most. French financial assistance was only about $65 million annually.3/ In addition, annual technical assistance grants of about $40 million financed thousands of French teachers in Algeria. Although France historically bought most Algerian wine exports at nearly double the world price, French imports of Algerian wine ceased entirely in the fall of 1970. Moreover, the French government promised politically powerful French grape growers at that time that future purchases would not be made. Although most Algerian goods other than wine and oil still entered France free of restriction, they totaled less than $50 million in 1969, or less than 10% of total French imports from Algeria.

3. *1970 was an exception; that year France finally transferred $170 million of the $200 million in loans promised Algeria under the 1965 Oil Accord as partial compensation for preferential tax treatment of French oil companies. All of this aid and most of the $30 million in loans transferred in 1969 were tied to importation of French goods.*

10. In 1970, Algeria's petroleum industry dominated economic relations between the two countries. Cumulative French gross investment in the oil industry reached about $1.4 billion, by far the major part of French investment in Algeria. Repatriated French oil earnings were about $215 million last year. Nearly 80% of ERAP and 20% of CFP 4/ production came from Algerian wells. About 60% of Algeria's petroleum exports went to France, providing roughly one-third of total French crude oil imports. Oil alone made up three-fourths 5/ of total Algerian exports to France. Capital goods, largely for the petroleum and petroleum-related industries, had supplanted consumer goods as Algeria's chief import from France. Although negotiations for a revised Franco-Algerian oil accord had been begun in November 1969 and Algerian demands for greater oil revenues and participation in the industry increased substantially, French companies continued to operate throughout 1970 with little difficulty.

Recent Developments

11. In early 1971 the prolonged negotiations, which had been expanded to include all aspects of Franco-Algerian economic relations, escalated to a confrontation. Changing world oil market conditions and concern over still large but declining financial resources caused Algeria to escalate its demands sharply. France responded by stiffening its position. Encouraged by highly favorable settlements in Libya and Persian Gulf states 6/ and by the rise in European

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4. ERAP and CFP are the two major French petroleum companies producing oil in Algeria. ERAP is totally French government owned and CFP is 35% government and 65% private owned.

5. Based on French data which is reported on a C.I.F. basis.

6. The Persian Gulf states had obtained an average increase of about 40¢ in revenues per barrel over the next five years and Libya of about 65¢ per barrel. Some 13¢ of the Libyan increase was a temporary increase to compensate for the freight advantage resulting from the closure of the Suez Canal.

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prices to above the previously preferential French price for Algerian crude oil, Algeria demanded revenue increases and greater interest in the French companies. Underlying the urgency of Algerian demands was a decline in foreign exchange holdings from about $600 million in January 1969 to about $400 million by January 1971, as oil output levels stagnated and imports continued to increase. Of particular concern to Algeria was its inability to increase oil output over the next year or so because of a pipeline bottleneck which precluded an increase in net foreign exchange earnings from oil without changing the tax structure or Algeria's share in production.

12. Frustrated by its inability to obtain a settlement, Algeria in late February nationalized 35% of French oil companies' assets, which raised its participation in each of these companies to 51%, providing majority control of operations and profits. By nationalizing only part of these companies, Algeria hoped to retain French marketing facilities and technical know-how while increasing Algerian profits. Subsequently, Algerian personnel were placed in nominal managerial control of production, and compensation for the nationalized assets was set by Algiers at $100 million, only a fraction of the amount claimed by French companies.

13. In April, Algeria unilaterally raised the tax reference price from $2.08 a barrel to $3.60 a barrel and eliminated the royalty credit against taxes.7/ These actions had the effect of increasing oil revenues from French companies from $0.78 a barrel to $1.83 a barrel.

14. The Algerian moves set off a series of retaliatory French actions that, together with prior Algerian moves, effectively terminated preferential economic ties. Although the French accepted the principle of nationalization, they objected to partial nationalization without a guaranteed right to repatriate their share of profits. They also considered the Algerian compensation offer unacceptable. Paris announced the end of financial assistance 8/

7. In 1970, Algeria imposed a tax reference price of $2.85 per barrel but quickly rescinded it.
8. Financial assistance (official loans and grants) is to be distinguished from technical assistance which continues.

and declared its intention to forgo all future wine purchases. France eliminated its protected market for Algerian crude oil, and French companies ceased paying taxes 9/ or transferring earnings to Algeria. 10/ Algeria responded by demanding $2.95 per barrel be paid in cash at Algerian ports when the French companies loaded oil tankers. Unable to realize a profit at that price, French companies stopped loading Algerian crude oil on 17 April 1971 and took measures to dissuade other companies from buying "French-owned" Algerian oil. These actions initially reduced Algerian oil exports to about 300,000 barrels per day -- 30% of their 1970 level.

Consequences of the Confrontation

15. All parties concerned -- France, the French oil companies, and Algeria -- have interests at stake in the current crisis. France risks the permanent loss of a traditional source for about one-third of its crude oil imports. France's balance of payments could be hurt slightly by loss of French companies' earnings repatriation from Algerian crude oil sales and by official Algerian efforts to reduce imports from France. On the political side, a final rupture with Algeria could reduce France's consciously cultivated influence in the Mediterranean and the Arab world. Two major French petroleum companies, ERAP and CFP, risk the loss of producing assets and profits. Algeria risks the permanent loss of a French market for 60% of its crude oil exports as well as the loss of French companies' technical expertise and marketing facilities. More seriously, Algeria's balance of payments could be adversely affected by French freezing of workers' remittances. France also could negate French trade preferences and curtail all foreign aid. Algerian development plans possibly could be impeded by French efforts to block international financing or a total curtailment of French trade with Algeria.

9. While all companies belonging to the ERAP group refused to pay taxes or transfer funds to Algeria, some CFP affiliates did pay taxes.

10. The 1965 Oil Accord provides for the retention of 50% of French petroleum companies' gross earnings in Algeria. However, because French companies receive payment for crude oil in France, the funds must actually be "repatriated" to Algeria.

16. Despite the range of interests at stake and regardless of how the current oil crisis is resolved, however, neither Algeria nor France will be seriously affected by ruptured economic relations. France had oil stocks for at least 90 days when Algerian supplies were interrupted and reportedly is having little difficulty obtaining substitute oil from other sources. The cost of French oil imports will be higher than in 1970, but the increase is due entirely to rising world prices; it still will be cheaper than if bought at demanded Algerian prices. Although repatriated earnings of French oil companies amounted to more than $200 million in 1970, subsequent tax increases imposed by the Algerian government now limit potential repatriation to only about $50 million annually. Algeria has instructed state firms not to place new orders in France, but the implementation of existing contracts will ease the impact. Reductions in French foreign exchange earnings would be at least partly offset by elimination of French financial assistance to Algeria.

17. Although French refusal to buy initially reduced Algerian crude oil exports by 70%, Algeria's lost earnings should be offset by increased sales eslewhere -- given time to find alternative markets -- and Libyan willingness to supply Algeria with substantial financial assistance in the interim. Algeria now is obtaining increased revenues in non-French markets because of rising oil prices. If the French embargo persists, Algeria should be able to replace all French sales easily by mid-1972, assuming a willingness to sell at competitive world prices. Even if the major oil companies supported the French companies by refusing to buy Algerian oil, the small Algerian output almost certainly would be taken entirely by independent oil companies. Although unusually light and not particularly suited for fuel oil production, Algerian oil has the advantages of being located near to markets and having a low sulfur content. Despite the French embargo, Algeria now is exporting at a rate of 40%-45% of the 1970 level and has contracted to sell significant additional quantities.

18. Withdrawal of French companies and their employees still in Algeria 11/ would cause only temporary

11. *CFP has already withdrawn 166 workers.*

difficulties, and Algeria almost certainly will be able to operate and maintain the oilfields itself. Algeria would simply hire needed foreign expertise abroad, possibly including some French company employees. Arrangements already have been made to hire 350-400 North Americans. Moreover, numerous US oil service companies now operating in Algeria in partnership with SONATRACH could and probably would facilitate hiring replacement personnel.

19. The loss of non-oil interests jeopardized by recent developments probably will have very little effect on Algeria's balance of payments. Imports of Algerian wine ceased after the 1970 French grape harvest, and strong opposition from politically powerful French grape growers would have curtailed any future imports. Terminated French financial aid was only about $60 million annually, and the French have declared their intention to continue technical assistance of $40 million per year. Freezing of workers' remittances would significantly lower Algerian foreign exchange receipts, but the French government does not appear to be inclined to take this step. In the unlikely event that France curtails exports to Algeria, many large development projects being built by French firms would be impeded until replacement sources could be located. With Libyan assistance of $200 million, Algeria should be able to finance all planned imports during 1971 without reducing its reserves (see Table 2). Furthermore, no problems are anticipated in 1972, when oil exports are expected to have regained 1970 levels. In the event of a satisfactory settlement, compensation payments made for nationalization (total or partial) by Algeria will almost certainly be offset by reduced or eliminated earnings repatriation by French companies.

20. The French oil companies, however, might be significantly injured by ruptured relations. Nearly 80% of ERAP's production is in Algeria, and its loss would force the company to develop other sources of production or greatly scale down crude oil operations. Losses to CFP would be less important, as only 20% of its crude oil is produced in Algeria. However, total loss to these companies would depend on Algerian compensation. Current Algerian compensation offers have been rejected as inadequate by French companies,

Table 2

Algeria: Projected Principal Balance of Payments Items

Million US $

	1969	1970 a/	1971	1972
Oil exports	586	700	650 b/	750 c/
Other exports	316	284	200	220
Imports d/	-1,022	-1,105	-1,270	-1,365
Workers' remittances	198	218	240	265
Repatriated oil revenues	-222	-215	-40 e/	--
Capital	73	74	220 f/	20 g/
Other	-9	N.A.	--	--
Change in reserves	-80	-44	0	-110

a. Preliminary.
b. Assumes resumption of oil shipments at 45% of the 1970 level by 1 May and of 60% of the 1970 level by 1 June.
c. Assumes that exports resume the 1970 level in June 1972.
d. Based on past trends and planned investment.
e. Includes $100 million in retroactive taxes paid Algeria by French companies.
f. Includes a $200 million loan from Libya.
g. Assumes no replacement of French foreign aid.

but could be raised if Algeria seriously desired a reproachment with France. 12/ Should a settlement enable French companies to retain Algerian assets under current tax laws, however, their taxes and royalty payments would be $1.83 per barrel, 135% higher than those paid in 1970. Profits would be $0.17 per barrel, 75% lower than in 1970. Under those circumstances, French companies would realize only about a 2% return on their total investment of $1.4 billion in Algeria.

Longer Term Prospects

21. Regardless of the outcome of the current oil situation, already seriously weakened commercial ties between France and Algeria will probably become even weaker. Algeria's share of the French oil market, which had been declining as a result of relatively constant Algerian production over the past several years, and French efforts to diversify crude oil sources, will probably fall even faster as some French refiners seek other suppliers. Algerian government policy denying French companies new construction contracts may continue, and government policy to diversify sources of capital goods will cause imports of French goods to decline. In recent years, Algeria has turned increasingly to other West European countries, particularly West Germany and Great Britain, and to the United States for capital equipment and technical know-how. Moreover, substantial increases in sales of liquefied natural gas to the United States, which are expected to begin by 1975, would almost certainly make the United States one of Algeria's two main trading partners.

22. Other vestiges of past special ties between Algeria and France also probably will disappear in time. France has promised to continue technical assistance grants at about past levels, but as Algeria gradually becomes able to meet its own needs, French technical assistance will slowly disappear.

Restriction-free importation of most Algerian goods other than citrus fruits, potatoes, wine, and petroleum continue, but if Algeria is successful in obtaining associate membership in the EEC, residual French trade preferences, which cover less than 10% of French imports from Algeria, probably will be removed.

Conclusions

23. Established during the colonial era and based on a series of preferential arrangements, the strong Franco-Algerian economic ties have been slowly eroded since Algerian independence in 1962. In 1971 the historic loosening of economic ties was greatly accelerated. Algeria partly nationalized French petroleum assets and hiked oil companies' taxes. French retaliation destroyed the hallmarks of past privileged relations: wine imports from Algeria are prohibited, financial aid has ended, and, most important, the protected market for Algerian crude oil is eliminated. Key oil issues remain unsettled, and the petroleum situation has escalated to crisis level, with French companies embargoing about 60% of Algerian crude oil exports.

24. Regardless of how the current oil crisis is resolved, neither Algeria nor France will suffer. France should be able to supply domestic demand from existing oil stocks and contracts under negotiation. Algeria should be able to resume 1970 export levels by mid-1972, and substantial Libyan aid will alleviate interim financial difficulties. Only French oil companies, who may lose substantial profits and assets, will suffer from the ruptured relations. In the longer run, most of the economic ties now terminated had already begun to deteriorate and those still in existence will probably disappear in time.